

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Notice of Inquiry Re: Provision of Default)	
Service)	D.T.E. 02-40
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INITIAL COMMENTS OF NSTAR ELECTRIC

Date: August 9, 2002

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I. INTRODUCTION

NSTAR Electric¹ (“NSTAR Electric” or the “Company”) hereby submits initial comments in response to the issues raised by the Department of Telecommunications and Energy (the “Department”) in its June 21, 2002, Notice of Inquiry (“NOI”) opening an investigation into the provision of Default Service.²

The Department’s NOI comes at the midpoint of the transition from an industry structure where generation service was provided primarily by electric utilities at regulated prices, to a structure where generation service is provided by a range of competitive suppliers with the utility providing default generation services at market-based prices. This transition was initiated by the Legislature’s passage of the Electric Restructuring Act of 1997 (the “Act”) which, among other things, established the market structure necessary to support full and fair competition in electric generation services. The Legislature’s actions resulted from a determination that the creation of a competitive market for electric generation would create tangible customer benefits, namely: rate

¹ NSTAR Electric is composed of Boston Edison Company, Cambridge Electric Light Company and Commonwealth Electric Company.

² The Department conducted a public hearing and technical conference in this proceeding on July 23, 2002.

reductions, the mitigation of stranded investment in utility generation facilities, increased development of generation facilities by independent, competitive entities, and lower forward-looking generation costs for all customers. At the same time, the provisions of the Act maintained strong customer protections and ensured the reliability and quality of electric service.

Using the competitive market as a tool for the achievement of customer benefits has been a success in Massachusetts. Since the enactment of the Act, customers have experienced real rate reductions and are shielded from the risk of stranded investment in utility generation plant. In addition, new, independent power plants are under development, thereby enhancing the reliability of electric service in the Commonwealth, while also providing a benefit to the environment. Most significantly, all customers – both large and small - have been the recipients of these successes.

At this stage of electric restructuring, the retail generation market is vibrant for larger commercial and industrial customers. These customers, especially those not eligible for standard offer service, have successfully entered the retail electricity market and opportunities to reduce their energy costs have been available. An extensive retail market has not yet developed for small commercial and residential customers who remain on Default Service, but these customers are realizing the benefit of competitive wholesale markets as distribution companies use their procurement experience to purchase energy on their behalf and are able to achieve the lowest possible prices for those customers.

In considering the future of Default Service, the Department should seek to identify and implement actions that are tailored to further the goals of the Act. To that end, the Department should evaluate proposed policy initiatives in light of a set of

guiding principles that reflect the goals and objectives espoused by the Legislature in creating the framework for a competitive generation market. These principles should include:

- In evaluating proposals for structuring default service, the Department should apply a standard that will result in measurable benefits to customers;
- Opportunities for direct access to retail markets should be allowed to develop at a different pace for different customer groups;
- Default Service prices should reflect no more and no less than the costs incurred to procure default service from the competitive market; and
- The concept of retail choice should be maintained and therefore customers should not be involuntarily assigned to retail suppliers.

NSTAR Electric's comments focus on how best to promote the successful development of the competitive market while ensuring that all customers enjoy the benefits of competitively priced generation service, with appropriate consumer protections. Accordingly, NSTAR Electric's comments first discuss the proposed guiding principles against which possible changes to Default Service should be measured, and second, provide recommendations based on such guiding principles.

II. COMMENTS

It is axiomatic that before one can begin to design a course of action, one must first identify the objective to be achieved. This means that, in this instance, the Department should first identify the "problems" it is trying to fix and the goals it is trying to achieve, before making a determination on the changes to be made to Default Service. In that regard, the identification of goals bears careful thought. In this proceeding, some commenters will likely suggest that the "problem" to be fixed is that, at this stage of the transition, too few residential and small commercial customers are served by the

competitive retail market. These commenters may suggest that the goal should be a post February 2005 electricity market where the vast majority of customers are served by competitive suppliers, with only a small, residual customer base relying on Default Service. Having set out this goal, and because smaller customers have not, to date, participated in the competitive market in large numbers, these commenters are likely to advocate that the Department and the Legislature take the risk of implementing a policy framework that would move residential and small commercial customers en masse off of Default Service into the competitive market. If such customers are not actively participating in the retail market by February 2005, these commenters would take the view that the Department and the Legislature will have failed to achieve the goals of the Act.

However, it is important to recognize that 100 percent participation by small commercial and residential customers, or “universal customer shopping,” is not necessarily an appropriate goal for the Department. Indeed, at this point, it is difficult to know exactly what level of customer participation in a mass market for energy is a good “target.” Some customers may find benefits from shopping in a retail mass market for electric generation services and others may not. Therefore, a more appropriate goal for the Department is the creation of a market structure that produces customer benefit; that provides a foundation for marketers to market; and that protects a customer’s right to choose. Under this view, the number of customers directly participating in the market is not an a priori goal that is set at a preordained level; but rather, is a result that is observed, after setting up an efficient market structure that allows customers to choose whether and when to participate in the mass market.

When viewed from this perspective, it is evident that under the current structure, virtually everything that the Act sought to achieve has been realized. Specifically, in finding that the promotion of a competitive generation market would be in the public interest, the Legislature stated that the primary elements of that market would be:

(1) customer choice; (2) preservation and augmentation of consumer protections; (3) full and fair competition in generation, and (4) enhanced environmental goals.

St. 1997, c. 164, § 1(l).

Each of these goals has the common thread of providing customers with demonstrable benefits through the promotion of the competitive electricity market, and each of these goals has been achieved. Therefore, NSTAR Electric believes that the Department should approach the task of improving Default Service with the same perspective in mind. Accordingly, before attempting to “fix” Default Service, the Department and the Legislature should make sure that the costs and benefits of any changes to Default Service procurement are analyzed thoroughly, and that any changes are designed to produce net benefits for customers.

Like the development of industry restructuring itself, proposed changes to Default Service should be evaluated in light of some overarching assumptions and guiding principles. See St. 1997, c. 164, §1. The following section sets out NSTAR’s view of the application of the proposed principles to the task at hand.

A. In Considering Changes to Default Service Policies, All Proposals Should Be Measured Against a Standard of Whether it Provides a Demonstrable Net Customer Benefit.

The Department has carefully reviewed the manner in which Default Service supplies are procured and priced in D.T.E. 99-60. These policies are consistent with the

framework established in the Act to move customers to the competitive market, while recognizing that the shift to a competitive model will take time and must be accomplished while maintaining the protections that Massachusetts customers have come to depend upon. In this manner, the Department's policies for Default Service are sound in that, consistent with the goals of the Act, they focus on the creation of a demonstrable net customer benefit. This means that the Department should not pursue policy initiatives that focus on the development of a competitive market structure as a goal in and of itself, but rather, the Department's policies should be designed to secure customer benefits using the competitive market as a tool to achieve that objective. For small commercial and residential customers, it may be difficult to obtain a benefit that warrants the costs that will be incurred to fundamentally modify the structure of Default Service.

B. Opportunities for Access to Retail Markets Have Developed at a Different Pace for Different Customer Groups

The Department is considering generally how Default Service may be provided in the context of a competitive industry and whether distribution companies should provide Default Service as a last resort. NOI at 6. Some view the participation of distribution companies in the procurement of Default Service for customers in a negative context, under a presumption that, to the extent that distribution companies are providing large numbers of customers with generation service, they have a vested interest in continuing to procure generation service for such customers indefinitely. The fact is that distribution companies are not in the generation business, make no profit from generation procurement, and have no vested self-interest in keeping large numbers of customers purchasing generation service via Default Service.

However, many electric distribution companies recognize that Default Service may be the only viable option for small, residential and low-income customers for the foreseeable future. Well-functioning wholesale markets, with substantial participation by large customers in the retail market, are the key to producing competitive benefits for all customers. Therefore, at a minimum, interested parties should support policies that promote a fair and competitive wholesale market. Moreover, the Department should continue to promote entry by larger customers into the retail market. This approach recognizes that opportunities for access to retail markets have developed at a different pace for different customer groups. This fact should not be a cause for alarm, but rather, should be considered evidence that Default Service procurement and provision should be shaped with two constituencies in mind: (1) residential and small commercial customers; and (2) larger commercial and industrial customers.

Recognizing that there are two constituencies in procuring and providing Default Service, allowing or requiring distribution companies to provide Default Service to customers “as a last resort” (or by choice) provides demonstrable customer benefits, and therefore, should be supported. Because of the experience of distribution companies in procuring Default Service for smaller customers, Default Service supply procured by distribution companies has proven to be both reliable and reasonably priced. Moreover, the Department can be assured that customers who purchase Default Service from distribution companies benefit from the full array of customer protections provided by

statute and Department regulation.³ In addition, some smaller customers may not wish to be “forced” into purchasing their generation supply from an entity other than their distribution company, because of the confusion that such customers perceive may result in dealing with electricity-service issues. The Department has recognized that “any decrease in consumer confidence caused by negative public reaction to allegations of electricity slamming could work against the Department’s long-term objective of establishing a robust competitive marketplace.” Competitive Market Initiatives, D.T.E. 01-54-B at 15.

Therefore, the Department should allow retail competition to develop at a different pace for small and residential customers. Further, the Department should recognize that distribution companies serve an appropriate role in serving small commercial and residential customers in the context of the development of the competitive retail market because such a framework provides customers with access to both: (1) market-priced generation; and (2) the Department’s broad customer protections, while at the same time minimizing customer confusion.

C. Default Service Prices Should Reflect No More and No Less Than the Costs Incurred to Procure Default Service from the Competitive Market

Default Service prices depend on various factors, including: (1) the costs incurred to procure the service; and (2) the term over which the service is offered. Based on Department precedent, Default Service customers currently have two pricing options:

³ Although an alternative Default Service provider might be required by distribution companies to agree to extend the same protections to customers as those offered by distribution companies, such protections likely would be extended only through contract, leaving alternative Default Service suppliers with only a cost/benefit analysis as incentive to adhere to the customer protection terms of their Default Service contract with distribution companies.

(1) a variable price that changes monthly; and (2) a fixed price that remains level for six months, calculated as the weighted average of the monthly prices. Default Service, D.T.E. 99-60-A at 6-9.

NSTAR Electric believes that new pricing options for Default Service are not needed, because customers currently have sufficient options to purchase generation via Default Service through variable or fixed (six month) pricing alternatives. However, in order to provide demonstrable net benefits to customers, the price of Default Service should reflect no more or less than the costs incurred to procure Default Service supply from the competitive market. Therefore, these costs could appropriately include both administrative costs for procuring default service supply and the costs related to unrecovered bad debts, provided that an appropriate relationship is maintained between base rates and default service rates in a transition to a new price structure. This approach ensures that Default Service rates will not be subsidized and thereby create an artificial price barrier to retail competition. It also ensures that customers are not forced to pay rates for Default Service that exceed market-based, competitively-established costs in an effort to spur customers to purchase generation service from competitive suppliers. This is particularly important because customers who do not have viable, direct access to retail competition, i.e., many residential and most low-income customers, should continue to benefit from competitive markets, and not be forced to pay higher rates for Default

Service so that others may be provided an “incentive” to procure generation service through a competitive supplier.⁴

In that regard, changes to the Department’s current policy regarding procurement strategies should be considered because of the possible customer benefits that might be realized with additional procurement options. In the Department’s previous Default Service proceeding, the Department directed distribution companies to procure Default Service supply for a period ranging from a minimum of six months to a maximum of one year. Default Service, D.T.E. 99-60-B at 16. In this proceeding, the Department should consider whether to allow quarterly or “staggered” procurement schedules with longer-term procurements for residential customers and relatively shorter-term procurements for commercial and industrial customers. This flexibility in Default Service procurement would allow distribution companies to make purchases that are in the customers’ best interests and that would result in the lowest reasonable price for customers.

For example, a staggered procurement approach, with longer-term procurements for residential customers, will promote price stability for these customers. Conversely, allowing procurement of Default Service for commercial and industrial customers for terms shorter than six months may provide better price signals to these customers, who may purchase generation service competitively if Default Service prices change at a rate more frequently than every six months. Accordingly, in order to provide demonstrable net benefits to customers: (1) Default Service prices should be equivalent to the costs

⁴ The Department correctly identified this concept in D.T.E. 99-60-A, at 11:

“While it is critical that all costs of providing Default Service be included in the retail price to provide an accurate price signal, it is inappropriate to include artificial costs for the purpose of spurring competition. Inclusion of such costs would inflate artificially the Default Service price and would not be consistent with the General Court’s mandate that the price of Default Service not exceed the average monthly price of electricity.”

incurred by distribution companies to procure Default Service supply, so that Default Service rates are neither subsidized, nor are artificially inflated; and (2) quarterly or staggered procurement schedules should be considered in order to provide price stability for smaller customers and appropriate price signals for larger customers who participate in the retail electricity market.

D. Retail Choice Should Be Maintained

In D.T.E. 01-54, the Department considered several issues such as the sharing of customer information with suppliers, including customer account numbers, in order to assist competitive suppliers in identifying potential customers, and to facilitate the enrollment of such customers with competitive suppliers. Competitive Initiatives, D.T.E.01-54-B at 13-16 (2002). Some participants in that proceeding recommended that the Department consider the more extreme option of requiring distribution companies to assign their Default Service customers to willing competitive suppliers without obtaining customer consent. See Id. at 6-7. NSTAR Electric strongly opposes this recommendation.

The Department should not consider any proposal that would result in the involuntary “slamming” of customers for the sake of spurring retail competition, because such a proposal would be: (1) in violation of the Act; (2) inconsistent with the Act’s promotion of retail choice; and (3) unlikely to provide customers with a demonstrable net benefit. As noted by NSTAR Electric in its Reply Comments in D.T.E. 01-54 (Phase II) (January 14, 2002), the involuntary, direct enrollment of customers would be in violation of the Act’s provisions mandating the affirmative consent of customers prior to enrollment (see G.L. c. 164, § 1F(8)). For this reason alone, such a recommendation in this proceeding must be rejected by the Department. However, mandatory assignment of

customers is also inconsistent with the Act's promotion of retail choice. The Act's comprehensive consumer protection provisions are designed to empower customers to make informed choices about competitive suppliers through disclosure requirements, affirmative enrollment procedures and rescission rights. Id. Mandatory assignment denies customers these protections and likely would promote customer dissatisfaction with the retail generation market.⁵ Accordingly, as a guiding principle in this proceeding, the Department should maintain a policy of spurring the competitive market by encouraging retail choice, rather than by forcing customers into a market in which they may have no desire to participate.

E. Summary

In the context of the assumptions and guiding principles, NSTAR Electric makes the following recommendations regarding Default Service:

- The price of Default Service should include no more and no less than those costs incurred to provide the service. These costs may include items such as uncollectibles and the administrative costs of procuring energy, provided that an appropriate relationship is maintained between base rates and default service rates.
- Default Service for large customers should be procured and priced on a short term basis, in order to maintain a close relationship between the price of default service and the market price of power.
- Default Service for small customers should be procured and priced over a longer term, in order to assure greater price stability for those customers.

⁵ It is unclear whether customers that have been assigned involuntarily to a competitive supplier would view the opportunity to purchase lower-priced generation service as somehow justifying a policy that required such an assignment. However, it is clear that many customers would be confused by such an assignment, and that such customers' dissatisfaction with electric restructuring could be widespread as a result. See Competitive Initiatives, D.T.E. 01-54-B, at 6 (2002). Moreover, as a practical matter, NSTAR Electric is aware of only one competitive supplier marketing its services to residential customers. Therefore, the lack of competitive suppliers willing to serve residential customers would make a mandatory assignment policy difficult to implement.

- Additional pricing options are not needed for customers, since customers currently have the option of variable or fixed (six month) pricing alternatives.
- Any mandated procurement process for Default Service should be flexible enough to allow distribution companies to make purchases that are in the customers' best interests and result in the lowest reasonable price for customers.

These recommendations provide the Department with several options for fine tuning the Default Service procurement process while preserving the most fundamental policy goals of the Act, i.e., to allow customers to choose their generation supplier and to maintain customer protections. These recommendations are also consistent with a goal of providing customers with a demonstrable net benefit in procuring Default Service and should be considered favorably by the Department.

III. CONCLUSION

NSTAR Electric appreciates the opportunity to submit comments in this proceeding and looks forward to participating in the Department's consideration of Default Service issues.

Date: August 9, 2002